

March 29, 2018

Dear clients and colleagues,

Thematic investing has always been a fundamental part of our investment process as we try to find companies that will be positively affected by these long-term secular growth drivers. One such driver, or theme, is demographics. In general, when people hear the term demographics, they often think about specific age groups—such as millennials or baby boomers. But populations are grouped under a wide range of labels—age or generation is just one of many categories.

Today we're looking at one of the most powerful demographics (and economic drivers) of our time: global obesity—or "globesity".

How big is globesity?

According to the World Health Organization (WHO), global obesity has almost tripled since 1975. Today, almost a third of the world population is obese—that's over 2 billion people. No single country has managed to reduce these rates, and at the current pace, it is estimated that over 50% of humanity will be either overweight or obese by 2030.

The US has the highest number of obese people, followed by China, India, Brazil and Mexico.

Emerging market growth at the cost of waistline expansion

"Nutrition Transition" is a term coined by the UN's Food and Agriculture Organization to describe obesity trends in emerging markets. It's true that GDP growth in emerging economies does come with some health risks. As their economies prosper, people adopt the eating and lifestyle habits of existing developed markets—namely sedentary routines and processed food diets—leading to a rise in obesity.

Traditional whole grains and vegetables are gradually replaced with meals that are higher in fat and sugar. Emerging markets are paying the price for this shift. These populations account for three-quarters of the global increase in people with diabetes.

Cost of globesity to the global economy = \$2 trillion

Obesity is one of the most pressing health challenges facing humanity today. It is the fifth leading risk for death in the world, causing 3.4 million adult fatalities every year. According to a study by McKinsey, based on 2010 disability-adjusted life years data from WHO, obesity cost the world a staggering \$2T in that year. And these numbers keep rising as high levels of obesity in children and mounting obesity in emerging markets are increasing the incidences of diseases like type 2 diabetes and cancer.

While the most recent data is still being processed, various research studies suggest obesity accounts for over 20% of all medical spending in the US. This should come as no surprise since obesity is associated with increased usage of numerous health care services, including patient care and prescription drugs.

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Anti-obesity investment opportunities

Investors can participate in four industries that are currently fighting the obesity epidemic:

- (1) Pharmaceuticals, Health Care & Medtech
- (2) Food, Food Retail, Quick Casual & Beverages
- (3) Weight Loss, Diet, Nutrition & Vitamin, Minerals and Supplements (VMS)
- (4) Sports Apparel & Equipment

1) Pharmaceuticals, Health Care & Medtech

According to the European Association for the Study of Obesity, overweight and obesity are the fifth leading risk for global deaths. At least 2.8 million adults die each year as a result of being overweight or obese. Obesity care covers a wide variety of services, ranging from pharmaceuticals to bariatric devices.

Weight-control prescription treatments work in two ways: 1) they suppress appetite, and 2) they make it harder for the body to absorb fats from consumed food.

When diet, exercise and prescription drugs don't do the trick, the last option is bariatric surgery. There are three types of surgical procedures available:

1. Restrictive procedures, which reduce the size of the stomach, leading to a feeling of fullness after eating small amounts of food;
2. Malabsorptive procedures, which bypass areas of the gastrointestinal tract, leading to lower absorption of digested food; and
3. Combination procedures, which involve both restrictive and malabsorptive elements

Medical device companies also benefit from obesity. Obese patients generate increased demand for cardiovascular devices such as heart valves, pacemakers and specialty catheters. Obesity is also a leading cause of osteoarthritis, as the excess weight puts additional pressure on joints, causing them wear out faster.

Dialysis products and services for patients with kidney failure are also expected to grow, with obesity as a key driver. Another obesity-related market that is on the rise is wound care and healing solutions. The higher incidence of diabetes is leading to more diabetic foot ulcers, one of the most difficult wounds to heal.

2) Food, Food Retail, Quick Casual & Beverages – What's on your plate and in your bottle?

One thing we know for sure is that the "modern" diet is a major part of the obesity problem. The largest source of calories for kids in the US is pizza, desserts and soda.

Fat and sugar are being called the new tobacco, and there is an increased call for calorie, sugar and/or fat taxes. More and more people are critical of skyrocketing calorie and sugar consumption, processed and fast food, misleading marketing practices, flawed nutritional labeling and other key factors in the weight gain

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epidemic. In recent years, developed market consumers have made a marked shift toward fresh and healthy foods.

Just look at your social media feed or switch on your TV. Chances are you'll see someone talking about health and wellness. Topics range from food supply and the latest fad diets, to exercise routines, micronutrients and meditation techniques. While the health and wellness industry is not new, its scale and intensity has certainly grown in recent years. It is estimated that this industry is now worth over US\$1T, and if growth continues as predicted, this market will soon rival the pharmaceutical industry.

Meanwhile, the food and beverage industry has recognized that the tide has turned and is adapting to new consumer preferences. Companies are investing in healthy product options, either through acquisitions or R&D. They've realized it's better to adapt willingly before health regulations force their hand. For most companies, the biggest challenge is striking a balance between healthy options and indulgent foods while maintaining profit margins. However, there are a growing number of players who focus exclusively on naturally healthy, fortified, organic, fresh produce, fresh juices and other such products.

3) Weight Loss, Diet, Nutrition & VMS - which approach works best?

Atkins, paleo, vegan, juicing...as people jump from one diet to another and seek out quick fixes to lose weight, several industries are gaining traction. Some of the biggest to benefit are commercial weight loss centre chains, dietary and weight-management supplements, meal replacement products and vitamin, minerals and supplements.

Commercial weight loss centres are seeing an increase in the number of dieters looking for products and services. Some of the most popular are lower-calorie food replacements and behavioural coaching to promote new eating habits.

In the US, researchers estimate that about 42%-55% of the adult population is currently dieting. The majority of them start out with a DIY plan, taking pointers from websites, diet books, fad diets and the numerous apps that are available. Needless to say, the diet market is filled with fickle-minded consumers who shift from fad to fad, similar to the fashion industry.

On the other hand, the vitamin, minerals and supplements industry is seeing consistent growth thanks to the rise of health-conscious consumers. Supplements based on natural or organic formulations are the fastest growing of the lot. However, this industry is not immune to headwinds such as product commoditization, price competition from online players and headline risks from medical studies questioning the effectiveness of such products.

4) Sports Apparel & Equipment - What should I wear to the gym today?

WHO estimates that 31% of adults are physically inactive—and that inactivity is the fourth leading cause of death. It is also the main cause of 21%-25% of breast and colon cancers, 27% of diabetes and a risk factor for

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high blood pressure, raised blood sugar and weight gain. According to the British Heart Foundation, physical inactivity accounts for 3% of health care costs in developed markets.

In general, it is well known that physical activity contributes to weight loss and weight maintenance over the long term. An active lifestyle also improves metabolic, respiratory and cardiovascular functions while reducing the risk of obesity.

As consumers become more aware of the risks associated with inactivity, we're seeing growing interest in fitness and sports—and by extension a greater demand for athletic apparel and equipment. The global retail athletic apparel industry is now worth an estimated \$300B, broken into three segments: athletic footwear, athletic apparel and equipment.

How is your portfolio exposed in the anti-obesity movement?

Most of the names below give Global Alpha direct or indirect exposure to companies participating in the fight to end globesity. We have highlighted several in previous weekly newsletters.

- (1) Pharmaceuticals, Health Care & Medtech: Globus Medical, US Physical Therapy, Lisi (Lisi medical division) and Raffles Medical Group.
- (2) Food, Food Retail, Quick Casual & Beverages: Frutarom, Ariake Japan, Biogaia, Norway Royal Salmon, Sodastream and Greggs.
- (3) Weight Loss, Diet, Nutrition & VMS: Vitasoy International and Limoneira
- (4) Sports Apparel & Equipment: Asics

In the coming weeks, keep an eye out for profiles of additional anti-obesity companies in our weekly commentaries. We are poised to leverage a wide range of opportunities emerging from the weight-loss movement in various industries and across the globe.

Have a good weekend.

The Global Alpha Team

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